



DEPARTMENT OF VETERANS AFFAIRS

8320-01

38 CFR Part 36

RIN 2900-AQ42

Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-out Home
Refinance Loans

AGENCY: Department of Veterans Affairs.

ACTION: Interim final rule.

SUMMARY: The Department of Veterans Affairs (VA) is amending its rules on VA-guaranteed or insured cash-out refinance loans. The Economic Growth, Regulatory Relief, and Consumer Protection Act requires VA to promulgate regulations governing cash-out refinance loans. This interim final rule defines the parameters of when VA will permit cash-out refinance loans, to include defining net tangible benefit, recoupment, and seasoning requirements.

DATES: Effective Date: This rule is effective [insert date 60 days after date of publication in the FEDERAL REGISTER].

Comment date: Comments are due on or before [insert date 60 days after date of publication in the FEDERAL REGISTER].

ADDRESSES: Written comments may be submitted by email through <http://www.regulations.gov>; by mail or hand-delivery to Director, Regulations Management (00REG), Department of Veterans Affairs, 810 Vermont Avenue,

N.W., Room 1063B, Washington, DC 20420; or by fax to (202) 273-9026. (This is not a toll-free number.) Comments should indicate that they are submitted in response to “RIN 2900-AQ42, Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-out Home Refinance Loans.” Copies of comments received will be available for public inspection in the Office of Regulation Policy and Management, Room 1063B, between the hours of 8:00 a.m. and 4:30 p.m. Monday through Friday (except holidays). Please call (202) 461-4902 for an appointment. (This is not a toll-free number.) In addition, during the comment period, comments may be viewed online through the Federal Docket Management System (FDMS) at <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT: Greg Nelms, Assistant Director for Loan Policy & Valuation, Loan Guaranty Service (26), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW., Washington, DC 20420, (202) 632-8978. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: On May 24, 2018, the President signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act), Public Law 115-174, 132 Stat. 1296. Section 309 of the Act, codified at 38 U.S.C. 3709, provides new statutory criteria for determining when, in general, VA may guarantee a refinance loan. The Act also requires VA to promulgate regulations for cash-out refinance loans within 180 days after the date of the enactment of the Act, specifically for loans where the principal of the new loan to

be VA-guaranteed or insured is larger than the payoff amount of the loan being refinanced. Pub. L. 115-174, 132 Stat. 1296.

VA's current regulation concerning cash-out refinance loans is found at 38 CFR 36.4306. VA is revising § 36.4306 in this rulemaking, and planning additional rulemakings to implement other provisions of the Act.

I. VA's Refinance Program and New Section 3709

A. Two Types of Cash-Out Refinance Loans Under Section 3709

Refinancing loans guaranteed or insured by VA have historically fallen into two broad categories: i) cash-out refinance loans (cash-outs) offered under 38 U.S.C. 3710(a)(5) and (a)(9) and ii) interest rate reduction refinancing loans (IRRRLs) authorized under 38 U.S.C. 3710(a)(8) and (a)(11). VA has not, until the enactment of the Act, seen any reason to delineate in VA's cash-out refinance rule, 38 CFR 36.4306, between cash-out refinance loans where the principal amount of the new loan is either: (a) higher than, or (b) less than or equal to, the payoff amount of the loan being refinanced. The Act, however, bifurcates cash-out refinance loans relative to payoff amounts of the loan being refinanced, effectively requiring VA to treat the cash-out refinance loans differently, notwithstanding the fact that they are both authorized under the same statutory authority.

Subsections (a), (b), and (c) of 38 U.S.C. 3709 set forth standards for fee recoupment, net tangible benefits, and loan seasoning, respectively, related to the refinancing of loans guaranteed or insured by VA. Subsections (a) through (c) all contain similar introductory text, providing that when a borrower refinances

a loan initially made for a purpose under VA's enabling statute in 38 U.S.C. 3710, the new refinance loan must meet the respective requirements of subsections (a), (b), and (c).

Subsections (a) through (c) do not expressly distinguish among the statutory types of refinancing loans that VA can guarantee or insure. While subsections (a) through (c) of section 3709 do not refer specifically to IRRRLs or cash-out refinance loans, subsection (d), which is identified under the statutory heading of "Cash-out refinances", explicitly states that subsections (a) through (c) do not apply to refinancing loans where the amount of the new loan is larger than the payoff amount of the loan being refinanced. The explicit delineation provided in subsection (d), i.e., the distinction between loan refinance amounts relative to loan payoff amounts, requires VA to consider cash-out refinances separately. Based on the way Congress structured section 3709, VA-guaranteed or insured refinance loans are now effectively grouped into three categories: i) IRRRLs, ii) cash-outs in which the amount of the principal for the new loan is equal to or less than the payoff amount on the refinanced loan (Type I Cash-Outs), and iii) cash-outs in which the amount of the principal for the new loan is larger than the payoff amount of the refinanced loan (Type II Cash-Outs). (For ease of reference, VA is referring in this preamble to the types of refinancing loans as IRRRLs, Type I Cash-Outs, and Type II Cash-Outs, respectively. VA is not using these terms in the rule text.)

It could be understood that, because the text of section 3709(d) does not make any specific reference to Type I Cash-Outs, such loans fall outside the

scope of section 3709 altogether. In other words, it could be suggested that subsections (a) through (c) apply solely to IRRRLs and subsection (d) applies to cash-out refinance loans, generally, both Type I and Type II. Had Congress specified that section 3709(a)-(c) applied to loans made for the purpose authorized in 38 U.S.C. 3710(a)(8) or solely to streamline refinance loans, or had Congress not been explicit in making subsection (d) apply solely to Type II Cash-Outs, VA would have understood the statute this way.

Nevertheless, the text of subsection 3709(d) omits Type I Cash-Outs. In addition, the introductory provisions of subsections (a) through (c) are substantially similar. They refer generally to 38 U.S.C. 3710, without distinction, requiring that if a loan is made for a purpose authorized under section 3710 and is then to be refinanced and guaranteed or insured by VA, the new refinancing loan is subject to the requirements of subsections (a) through (c). On the plain text of subsections (a) through (d), then, the statute requires VA to apply subsections (a) through (c) to all refinances not expressly excepted under subsection (d). Thus, VA understands subsections (a) through (c) to apply to IRRRLs and Type I Cash-Outs and subsection (d) to apply to Type II Cash-Outs.

VA is revising its cash-out refinance rule at 38 CFR 36.4306 to address the new statutory bifurcation. The rule will outline the common characteristics required for the guaranty or insurance of Type I and Type II Cash-Outs. It will also set apart each type of cash-out refinancing to address their unique aspects. VA is further making some technical changes for ease of reading. All the

changes are explained in-depth, later in this preamble. VA is not addressing section 3709's impact on IRRRLs, but plans to do so in a separate rulemaking.

B. The Structure of Section 3709(b) and (d) and How It Affects Type I and Type II Cash-Outs

As explained, section 3709 bifurcates cash-out refinance loans into two types. Type I Cash-Outs are subject to 38 U.S.C. 3709(a) through (c). Type II Cash-Outs are subject to subsection (d). Subsections (a) through (c) provide specific criteria before a Type I Cash-Out may be guaranteed or insured.

Subsection (a) imposes requirements related to recoupment of fees and expenses when refinancing a VA-guaranteed or insured loan into a Type I Cash-Out. In this rule, VA is simply restating the statutory criteria Congress prescribed in 38 U.S.C. 3709(a). Likewise, VA is simply restating in this rule the statutory criteria found in subsection (c), which imposes a seasoning period before a VA-guaranteed or insured loan may be refinanced into a Type I Cash-Out. To the extent any changes are made, they are solely for ease of reading and should not imply a substantive effect. VA is required to follow the statute.

Subsection (b) requires that a refinance loan provide a net tangible benefit to a veteran. To that end, the lender must provide a veteran with a net tangible benefit test to ensure that the refinance is in the financial interests of the veteran. Congress required the test, but did not define its parameters. To clarify statutory ambiguity, VA is, therefore, providing the parameters, as described later in this preamble.

VA considered various interpretations in dealing with section 3709(b). As discussed above, one question was whether the section applies only to IRRRLs, excluding Type I Cash-Outs altogether. This would be untenable, however, as the plain text of the introductory paragraph states unambiguously that it applies broadly to VA-guaranteed or insured refinances of VA-guaranteed loans—IRRRLs and cash-outs—except for those Type II Cash-Outs expressly excepted. The reading also would not make sense in application, as it would create a loophole for Type I Cash-Outs, making it easy for unscrupulous lenders to exploit veterans by inflating interest rates and discount points, without regard to net tangible benefits or the recoupment of fees and expenses. Such a loophole is inconsistent with the statute, as such lenders could render the whole of (a) through (c) meaningless.

VA also considered whether the net tangible benefit test described in (b)(1) was introductory to the criteria set forth in (b)(2) through (4). In other words, VA analyzed whether the required interest rate reductions, restricted discount points, and capped loan-to-value ceilings of paragraphs (2) through (4) comprise, in total, the net tangible benefit test mentioned in paragraph (1). This reading also was untenable, however, due to the way Congress structured the plain text of subsection (b). Subsection (b) contains four paragraphs, not three. Had Congress intended for paragraphs (2) through (4) to comprise the net tangible benefit test, Congress would have made the net tangible benefit test part of the introductory text as an overarching requirement, leading into the list of various elements necessary for passing the test. Yet the equal paragraph

structure of the law clearly sets the net tangible benefit test as one criterion of equal weight among others necessary to be met for guaranty or insurance.

VA further considered the placement of the conjunction “and” between paragraphs (3) and (4). Generally, when Congress enacts a statute that lists multiple standards, utilizing serial commas and conjoining such discrete standards with the word “and” at the end, each discrete provision must be applied to the subject of the statute. U.S. House of Representatives Office of the Legislative Counsel, House Legislative Counsel's Manual on Drafting Style, No. HLC 104-1, sec. 351 at 58 (1995). The problem with accepting this principle across the board is that “and” is often ambiguous. It can be used jointly or severally. See R. Dickerson, *The Fundamentals of Legal Drafting*, 76-85 (1965). When courts deviate from the generally accepted principle, the outcome is largely dependent on facts and context. See, e.g., *Shaw v. Nat'l Union Fire Ins. Co.*, 605 F.3d 1250 (11th Cir. 2010), which catalogs several cases where “and” proved difficult to understand.

One rationale for departing from the generally accepted principle is when courts must reconcile the understanding between two mutually exclusive concepts. *Id.* The rationale applies here. The statutory use of the term “and” cannot apply as it generally would, because two of section 309(b)'s criteria are mutually exclusive. Of the four paragraphs in subsection (b), there is one that can apply in every case and two that cannot apply simultaneously. The fourth is dependent. Paragraph (1) provides that refinances of already-guaranteed loans cannot be guaranteed by VA unless “the issuer of the...loan provides the

borrower with a net tangible benefit test...” This paragraph is broad enough to apply in the case of all covered loans. Paragraph (2) describes a case where the underlying loan and the refinancing loan both have a fixed interest rate.

Paragraph (3) defines a case where the underlying loan has a fixed interest rate and the refinancing loan will have an adjustable interest rate. It follows that paragraph (2) can never apply in the case of a loan described in paragraph (3), and vice versa. They are mutually exclusive, which indicates that the “and” between paragraph (3) and (4) cannot mean that a single refinancing loan must meet all of subsection (b)’s requirements.

Since the “and” between paragraph (3) and (4) could not mean that all paragraphs (1) through (4) must be applied and satisfied in every single refinance, VA had to determine the meaning. Put another way, VA had to analyze whether the discount points requirement would apply only when refinancing from a loan with a fixed rate to a loan with an adjustable rate (paragraph 3), or if it would also apply when refinancing from a fixed rate loan to a fixed rate loan (paragraph 2).

VA found no legislative history to help clarify the term’s meaning. For the reasons explained below, VA interprets the “and” to link only paragraphs (3) and (4).

A common usage of the term “and” is one that indicates an order of sequence. Even if not the preferred legal understanding (see explanation above), it offers an alternative that resolves the apparent ambiguity.

Accepting this understanding of “and”, the discount points requirement described in paragraph (4) would clearly follow in sequence the condition prescribed in paragraph (3). The first step of moving from a fixed interest rate mortgage to an adjustable interest rate mortgage would parallel the example of the President signing a bill into law. The next step in the sequence, i.e., compliance with discount points requirements, would be analogous to the rulemaking in the example.

One could argue that the same rationale could apply to paragraphs (2) and (4). If a veteran obtains a loan described in paragraph (2), the next step in the sequence would be to apply paragraph (4). The problem is that paragraph (3) intervenes, and paragraphs (2) and (3) are sequential in number only.

Paragraphs (2) and (3) present different classes of loans entirely, carrying with them different risks. Again, they are mutually exclusive to one another. This exclusivity seems to interrupt the consequential element necessary for continuation of the sequence. If paragraphs (2) and (3) were reconcilable, meaning they could either occur simultaneously or follow one another, one could look to paragraph (4) to complete the sequence. But the differences must be given meaning, and VA interprets that meaning as severing the relationship between paragraphs (2) and (4), limiting to paragraph (3) the relationship with paragraph (4).

VA recognizes other conclusions might be possible. However, VA’s interpretation implements the text, on its face, as a coherent and consistent framework, without having to consider whether Congress made a structural error.

The coherent and consistent framework mirrors VA's understanding of the lending market. A refinance loan should meet a net tangible benefit test to ensure that imprudent lenders do not take advantage of veterans and the investors who provide liquidity for VA-guaranteed loans. Additional requirements are tacked on as the risk profile increases. In VA's understanding, Congress addressed the risky aspects of moving from one type of interest rate to another, setting an additional threshold regarding interest rates, depending on what sort of interest rate (fixed versus adjustable) a veteran chooses. Congress addressed the least risky type of loan first, meaning a refinance from a fixed interest rate to a fixed interest rate. The required interest rate shift (50 basis points) is drastically less than that required when refinancing from a fixed interest rate to an adjustable interest rate (200 basis points). VA understands that, although there can be benefits in moving from a fixed interest rate to an adjustable rate, such a move is inherently risky. One reason is that the crossover to a different category of mortgage makes it more difficult for the average borrower to conduct an informed cost-benefit analysis when comparing the two types of mortgages. Where moving from a fixed interest rate mortgage to another fixed rate is like comparing apples to apples, comparing a fixed interest rate mortgage and an adjustable rate mortgage is more like comparing apples to pears. They are simply different, and as a result, borrowers could have a more difficult time calculating an accurate cost-benefit analysis. Also, the adjustable rate means that the monthly payment is essentially out of the borrower's hands, particularly in a time when interest rates are increasing. Thus, the adjustable rate carries

with it more risk of payment shock (when the rate is adjusted and a higher payment amount is established) and more chance that a veteran would later opt to refinance again, increasing the risk of serial refinancing and equity stripping. VA understands the more significant interest rate reduction for an adjustable interest rate mortgage, along with the additional discount point and loan to value requirements, as Congress's attempt to counter the potential downsides of the riskier type of loans.

Before moving to the next point, it should be noted, as well, that linking paragraph (4) to both paragraphs (2) and (3) is a restrictive approach. It would result in VA establishing a larger regulatory footprint than if VA were to link paragraph (4) only to paragraph (3). VA is reluctant to take the more restrictive interpretation for this aspect of the rule. VA does not have data, at least at the moment, to demonstrate how linking the additional restrictions of paragraph (4) to paragraph (2) would provide veterans additional advantages. VA also cannot point to data showing a clear market-based reason to impose the larger regulatory footprint. VA does not have other evidence that the more restrictive approach reflects the meaning of the ambiguously structured statute. Nevertheless, VA specifically invites comments on its interpretation of subsection (b), as VA believes it would be helpful to receive public feedback on this important issue.

Finally, VA considered whether a Type I Cash-Out would need to pass a net tangible benefit test to comply with the law or whether the net tangible benefit test is merely a disclosure for informational purposes. The meaning of a word

must be ascertained in the context of achieving particular objectives. See *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 861 (1984). VA first reviewed the Act to determine whether another section could provide additional context. The term “net tangible benefit test” is not used elsewhere in the Act. Neither is the term “test”. The nearest analog VA could find in the Act was in section 401, referring to “supervisory stress tests.” Under section 401, the Board of Governors of the Federal Reserve System is required to conduct supervisory stress tests of certain bank holding companies “to evaluate whether such bank holding companies have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.”

VA does not believe the section 401 supervisory stress test is a valid comparison to section 309’s net tangible benefit test. A supervisory stress test based on estimates and forecasts of economies seems a completely different character from a test to show whether a lender is preying upon an individual borrower. The objectives are entirely different. “Context Counts.” *Env’tl. Def. v. Duke Energy Corp.* 549 U.S. 561 (2007) (explaining that “There is, then, no ‘effectively irrebuttable’ presumption that the same defined term in different provisions of the same statute must be ‘interpreted identically.’”

Guaranteeing a loan when VA and others know it would cause a veteran financial harm would be inconsistent with the statutory context of section 309. In paragraph (2) of subsection (b), Congress required that a fixed rate refinance loan must meet certain interest rate requirements, or the Secretary is not authorized to guarantee the loan. In paragraphs (3) and (4), Congress required

that an adjustable rate refinance loan must meet certain interest rate and discount point requirements, or the Secretary is not authorized to guarantee the loan. If each of these other provisions in subsection (b) sets forth a pass/fail standard that must be met, not just disclosed, VA finds it difficult to conclude that merely disclosing the fact that a loan is harmful would be sufficient to satisfy the net tangible benefit test of paragraph (1). It would be inconsistent to do so.

The consistency in the legislative scheme is not limited to the requirements of subsection (b). The same pass/fail sort of standard applies to the recoupment requirements of subsection (a). If one of the recoupment requirements is not met, the refinance loan cannot be guaranteed. The same pass/fail sort of standard also applies to the seasoning requirements of subsection (c). If the requirement is not met, the loan cannot be guaranteed.

Again, VA interprets the law within the coherent and consistent framework that Congress prescribed. At each step, in every provision in section 309, Congress identified an issue, imposed a requirement, and prohibited a VA guaranty as the consequence of noncompliance with one of the section's requirements. It would be inconsistent with this coherent statutory scheme if the consequence of noncompliance with the net tangible benefit test of subsection (b)(1) would be wholly different. To infer the term "net tangible benefit disclosure" within this context when Congress selected the term "net tangible benefit test," would not only fail to give the proper weight to the word selection, but would also require an inference, without evidence, that Congress had departed from the coherent framework it had designed. VA believes it would run

counter to the purpose of a statute entitled the “Protecting Veterans from Predatory Lending Act” for VA to guarantee or insure a loan when all parties involved—lender, veteran, VA, secondary market investors, and Congress—know a loan fails a net tangible benefit test, meaning that the loan is predatory and indeed will cause financial harm. See *INS v. National Ctr. for Immigrants’ Rights*, 502 U.S. 183, 189-90 (1991) (acknowledging that title of statute can aid in resolving ambiguity in text).

Furthermore, for additional context in interpreting the meaning of the term “test”, VA looked at other Government-backed lending programs: HUD, the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Department of Agriculture’s Rural Development program. The consensus approach is that, absent a net tangible benefit to a borrower, the loan should not be made.

Accordingly, VA is interpreting section 309’s net tangible benefit test as one that must be passed. VA believes that, by selecting the word “test”, Congress has imposed a requirement to establish the fitness of the loan, as opposed to a requirement only to disclose the characteristics of the loan for the veteran’s understanding.

In this rule, VA is defining the parameters of the net tangible benefit test for Type I Cash-Outs. VA is also establishing a net tangible benefit test for Type II Cash-Outs to comply with section 3709(d). The net tangible benefit test for both types of cash-outs overlaps in some ways, but also differs in a few major

respects. The full explanation is provided later in this preamble. VA will address the net tangible benefit test for IRRRLs in a future rulemaking.

II. Explanation of Specific Changes to 38 CFR 36.4306

A. Section 36.4306(a)

For ease of reading, VA is revising § 36.4306(a) to discuss the criteria that will apply to both types of cash-out refinance loans. In § 36.4306(a), VA will provide that a refinancing loan made pursuant to 38 U.S.C. 3710(a)(5) qualifies for guaranty in an amount as computed under 38 U.S.C. 3703, provided five conditions are met.

1. Reasonable value

VA will require that the amount of the new loan must not exceed an amount equal to 100 percent of the reasonable value, as determined by the Secretary, of the dwelling or farm residence which will secure the loan. The Secretary makes determinations of reasonable value pursuant to requirements found in 38 U.S.C. 3731. VA's implementing regulations are found at 38 CFR sections 36.4301 and 36.4343, and VA's website provides additional resources for fee appraisers. See <https://www.benefits.va.gov/homeloans/appraiser.asp>. The current § 36.4306(a) authorizes a loan in an amount that does not exceed 90 percent of the reasonable value of the dwelling securing the VA-guaranteed loan. 38 CFR 36.4306(a)(1). In 1989, Congress established a 90 percent loan-to-value ratio limit for cash-outs. See Pub. L. 101-237 sec. 309(b)(3), 103 Stat.

2062. In 2008, Congress enacted Pub. L. 110-389, which increased the loan-to-value ratio limit for cash-outs to 100 percent. See Pub. L. 110-389 sec. 504(b); 122 Stat. 4145. The 100-percent loan-to-value ratio remains intact in the statute, and VA has been complying with this amendment. Yet VA has not changed its rule to reflect the 2008 change. VA is, therefore, aligning its rule with the statutory text to ensure that veterans have full access to their home loan benefits as authorized by Congress. This regulatory change has no substantive impact as VA has applied the statutory 100 percent ratio via its policy and procedural guidance to lenders since Congress enacted section 504 of Public Law 110-389, the Veterans' Benefits Improvement Act of 2008, 122 Stat. 4145. See also Lenders Handbook, VA Pamphlet 26-7, Chapter 3, Topic 3, Page 3-8.

2. Funding fee

VA will require that the funding fee as prescribed by 38 U.S.C. 3729 may be included in the new loan amount, except that any portion of the funding fee that would cause the new loan amount to exceed 100 percent of the reasonable value of the property must be paid in cash at the loan closing. The statute at 38 U.S.C. 3729(a)(2) authorizes borrowers to finance the funding fee. However, as stated in connection with the reasonable value requirement, 38 U.S.C. 3710 requires that cash-out refinance loan amounts not exceed 100 percent of the reasonable value of the property securing the loan. 38 U.S.C. 3710(b)(7)-(8). Therefore, VA is clarifying that, while a funding fee may be financed, it must not increase the loan to value ratio such that the loan would violate 38 U.S.C. 3710. For any overage, a veteran must bring the funds to pay at loan closing.

3. Net tangible benefit

For the reasons explained above, VA will require that the new loan must provide a net tangible benefit to the borrower. For the purposes of § 36.4306, net tangible benefit means that the new loan is in the financial interest of the borrower. The lender of the new loan must provide the borrower with a net tangible benefit test and that test must be satisfied.

First, the new loan must meet one or more of the following: the new loan eliminates monthly mortgage insurance, whether public or private, or monthly guaranty insurance; the term of the new loan is shorter than the term of the loan being refinanced; the interest rate on the new loan is lower than the interest rate on the loan being refinanced; the payment on the new loan is lower than the payment on the loan being refinanced; the new loan results in an increase in the borrower's monthly residual income as explained by § 36.4340(e); the new loan refinances an interim loan to construct, alter, or repair the home; the new loan amount is equal to or less than 90 percent of the reasonable value of the home; or the new loan refinances an adjustable rate loan to a fixed rate loan.

VA has chosen these eight criteria because VA believes a loan that meets at least one of these criteria helps demonstrate that the loan is in the financial interest of the borrower. For example, a lower interest rate, a lower payment, or elimination of monthly mortgage insurance will be in the financial interest of the borrower by reducing the debt service the borrower must cover each month. In many cases, lowering the interest rate or reducing the monthly payment through elimination of monthly mortgage insurance will also decrease the overall cost to

the borrower over the life of the loan. In cases where the monthly payment is lowered but the overall cost of the loan will increase (e.g., borrower refinances an existing loan with five years' worth of payments remaining into a new 15-year loan, takes \$20,000 in cash out, and realizes a reduction of only 50 basis points), VA believes that the refinance loan may still be in the borrower's financial interest, as the veteran might need access to cash for certain expenses (e.g., home repair for livability, medical bills, or educational expenses). Additionally, VA notes that the loan comparison disclosure mandated by this rule, and discussed in more detail below, will provide the borrower with upfront information about the overall cost of a loan, thereby helping the borrower make an informed decision about whether to proceed with the refinance loan.

A shorter-term loan will be in the borrower's financial interest as the borrower will be paying off the loan in a shorter amount of time. Given that all cash-out refinance loans must be fully underwritten and the borrower must demonstrate an ability to repay, VA sees little downside to a borrower who chooses to refinance his or her loan to a shorter term, as a borrower will most likely end up paying less interest over the life of the loan.

VA also finds that a new loan resulting in an increase in the borrower's monthly residual income as explained by § 36.4340(e) will be in the financial interest of the borrower by providing additional liquidity to the borrower. For example, in cases where borrowers use a cash-out refinance to pay down higher interest rate consumer debts (e.g., credit cards and automobile loans), borrowers

use the equity in their home to consolidate debts at a lower interest rate, which results in a lower monthly debt-to-income ratio.

A new loan that refinances an interim loan to construct, alter, or repair the home will provide a financial benefit to the borrower by refinancing out of a loan that is costly to maintain, if it can be maintained at all. Generally, this criterion would apply to borrowers who have obtained a conventional interim construction loan (i.e., one not guaranteed by VA) and who plan to refinance into a permanent VA-guaranteed loan. Such refinancings enable veterans to avoid costly mortgage insurance. In addition, if the reasonable value of a completed construction project exceeds the amount of the original construction loan, a veteran could recoup certain out-of-pocket expenses the veteran incurred during construction. For example, if a veteran obtained an original construction loan in the amount of \$200,000 and the reasonable value of the completed project was \$210,000, the veteran could recoup, by refinancing into a new loan, up to \$10,000 of any personal funds expended during the construction process.

A new loan that is equal to or less than 90 percent of the home's reasonable value will also provide a financial interest to the borrower because at least 10 percent of home equity is maintained. Such equity can, for example, leave some room for a future loan modification if the borrower experiences a temporary reduction in income. Also, maintaining and building home equity is in any homeowner's interest as such equity represents an investment and reduces the likelihood that, when property values fall, a homeowner will be left with a mortgage that exceeds the value of the home (i.e., an "underwater mortgage").

VA acknowledges that under 38 U.S.C. 3710 VA is authorized to guarantee certain housing loans with balances equal to 100 percent of the reasonable value of a property. However, VA views 10 percent equity preservation as one criterion out of many that can evidence that a refinance loan provides a net tangible benefit to a borrower. Accordingly, VA is incorporating the 90 percent loan to value criterion into the net tangible benefit test.

VA finds that refinancing from an adjustable rate loan to a fixed rate loan will provide a financial benefit to the borrower by providing a stable interest rate over the life the loan. Generally, borrowers obtain adjustable rate loans to aid in affording a home for a short period (i.e., three to five years). However, when circumstances change (e.g., a change in employment, an increase in benchmark interest rates, or a decision to stay in a home longer) a fixed rate may be more affordable and may provide more certainty in the long term. Enabling borrowers to refinance to a fixed rate, even if such rate is higher than the introductory adjustable rate, can be in a veteran's financial interest.

Second, the lender must provide a borrower with a comparison of the following: the loan payoff amount of the new loan, with a comparison to the loan payoff amount of the loan being refinanced; the new type of loan, with a comparison to type of the loan being refinanced; the interest rate of the new loan, with a comparison to the interest rate of the loan being refinanced; the term of the new loan, with a comparison to the term remaining on the loan being refinanced; the total the borrower will have paid after making all payments of principal, interest, and mortgage or guaranty insurance (if applicable), as

scheduled, for both the new loan and the loan being refinanced; and the loan to value ratio of the new loan, with a comparison to the loan to value ratio under the loan being refinanced.

Third, the lender must provide the borrower with an estimate of the dollar amount of home equity that, by refinancing into a new loan, is being removed from the reasonable value of the home, and explain that removal of this home equity may affect the borrower's ability to sell the home at a later date.

VA will require the lender to provide the above information in a standardized format on two separate occasions: not later than 3 business days from the date of the loan application and again at loan closing. The borrower must certify that the borrower received this information on both occasions.

Requiring lenders to provide borrowers with the above information on two separate occasions will enable borrowers to better understand their cash-out refinance loan transaction and, therefore, make a sound financial decision. VA believes this information will help borrowers avoid costly mistakes that may strip their home equity or make it difficult to sell or refinance their home in the future.

4. Reasonable discount

VA will require that the dollar amount of discount, if any, to be paid by the borrower must be reasonable in amount as determined by the Secretary in accordance with § 36.4313(d)(7)(i). This requirement is found in current § 36.4306(a) and is revised for clarity only.

5. Otherwise eligible

VA will require that the loan must otherwise be eligible for guaranty. This requirement is found in current § 36.4306(a).

B. Section 36.4306(b)

VA is revising § 36.4306(b) to discuss the additional criteria the Act provided for Type I Cash-Outs. Again, Type I Cash-Outs are cash-out refinance loans where the loan being refinanced is already guaranteed or insured by VA and the new loan amount is equal to or less than the payoff amount of the loan being refinanced. Section 3709 set out specific criteria for recoupment and seasoning for these types of loans. VA is adopting those criteria.

For recoupment, there are three criteria. First, the lender of the refinanced loan must provide the Secretary with a certification of the recoupment period for fees, closing costs, and any expenses (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) that would be incurred by the borrower in the refinancing of the loan. Second, all the fees and incurred costs must be scheduled to be recouped on or before the date that is 36 months after the date of loan issuance. Finally, the recoupment must be calculated through lower regular monthly payments (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) as a result of the refinancing loan.

For seasoning, the new loan may not be guaranteed or insured until the date that is the later of 210 days from the date of the first monthly payment made

by the borrower and the date on which the sixth monthly payment is made on the loan.

In addition to requiring that the lender of the refinanced loan provide the borrower with a net tangible benefit test, section 3709 also prescribes three net tangible benefit criteria for Type I Cash-Outs. VA is adopting those criteria. First, in a case in which the loan being refinanced has a fixed interest rate and the new loan will also have a fixed interest rate, the interest rate on the new loan must not be less than 50 basis points less than the loan being refinanced. Second, in a case in which the loan being refinanced has a fixed interest rate and the new loan will have an adjustable rate, the interest rate on the new loan must not be less than 200 basis points less than the previous loan. Also, when a borrower is refinancing from a fixed interest rate loan to an adjustable rate loan, the lower interest rate must not be produced solely from discount points, unless such points are paid at closing and such points are not added to the principal loan amount. Such points may be added to the principal loan amount, however, when they are paid at closing and: (i) the discount point amounts are less than or equal to one discount point, and the resulting loan balance after any fees and expenses allows the property with respect to which the loan was issued to maintain a loan to value ratio of 100 percent or less, and (ii) the discount point amounts are greater than one discount point, and the resulting loan balance after any fees and expenses allows the property with respect to which the loan was issued to maintain a loan to value ratio of 90 percent or less.

C. Section 36.4306(c)

VA is redesignating § 36.4306(c) and (d) as § 36.4306(d) and (e) and adding a new § 36.4306(c). In new § 36.4306(c), VA is adding the criteria for Type II Cash-Outs, meaning those cash-out refinance loans where the new loan amount is greater than the payoff amount of the loan being refinanced. For recoupment, VA is stating that meeting the requirements of paragraph (a) is sufficient. This is because it is impossible for VA to determine how to quantify recoupment for veterans who obtain this type of refinance. For example, a veteran may choose to refinance so that the veteran may use home equity to pay for a child's college tuition or help pay for nursing services for a loved one. The reasons veterans may choose to tap into their home equity are countless. VA is concerned that, if VA attempted to establish a recoupment period for this type of loan, VA would put a veteran in a worse financial position than a non-veteran, and that is not VA's intention.

For proper seasoning of the VA-guaranteed loan, VA is adopting the same criteria found in § 36.4306(b)(2) for Type I Cash-Outs, just stated in a different way. The difference is in form only. Where it made sense structurally for § 36.4306(b) to include the requirement in the introductory text, it did not make sense structurally in § 36.4306(c). Accordingly, VA is spelling out that the seasoning period is the later of 210 days from the date of the first monthly payment made by the borrower and the date on which the sixth monthly payment is made on the loan; however, this requirement applies only when the loan being refinanced is a VA-guaranteed or insured loan.

VA is applying the same seasoning standards for Type II Cash-Outs that Congress explicitly set forth for IRRRLs and Type I Cash-Outs because the 210-day/6-monthly payment seasoning requirement is consistent with other federal seasoning requirements for cash-outs and is a viable standard in protecting veterans from predatory lending and safeguarding the financial interest of the United States. For example, housing loans insured by the Federal Housing Administration (FHA) with fewer than six months' worth of payment history are not eligible for cash-out refinances. See U.S. Department of Housing and Urban Development (HUD), Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans Handbook (4155.1), Chapter 3, Section B.2.b., available at https://www.hud.gov/sites/documents/4155-1_3_SECB.PDF (last visited Nov. 20, 2018).

VA's analysis does not suggest a compelling reason to establish a novel seasoning standard for Type II Cash-Outs. In completing its regulatory impact analysis for this interim final rule, VA reviewed Type II Cash-Outs closed in fiscal years 2016, 2017, and 2018 (through July 2018). The vast majority of these refinance loans (96.8 percent) would have passed the 210-day seasoning requirement adopted in this rule, which indicates that VA's Type II Cash-Out portfolio is already achieving the Type I Cash-Out statutory seasoning requirement, as well as those now fairly well-accepted as industry standard for refinances generally (as explained above). VA does not believe that extending the seasoning period would provide substantially more protection to the financial

interests of veterans. Rather, VA's analysis demonstrates that a net tangible benefit test would be more effective in preventing riskier Type II Cash-Outs.

D. Section 36.4306(d)

VA is revising paragraph (d) to delimit the scope of the provision. The purpose of paragraph (d) is to explain the calculation of entitlement for non-streamlined refinances. It ensures that a veteran is not precluded from refinancing solely because entitlement has already been used on the loan being refinanced. Where the current rule states, "nothing shall preclude..." guaranty, however, VA is concerned that it might be easily misunderstood as superseding provisions related to seasoning, recoupment, etc. Therefore, VA is clarifying that paragraph (d) is for the limited purpose of calculating entitlement. No substantive change is intended.

E. Section 36.4306(f)

Similarly, VA is revising paragraph (f) to clarify its scope of application. Paragraph (f) states that "[n]othing in this section shall preclude the refinancing..." of a land purchase related to new construction. The purpose of the rule is to ensure stakeholders understand that, if a loan was originally made for a land purchase only, refinancing for the home construction is acceptable under 38 U.S.C. 3710. The current rule, however, is overly broad, in that it could easily be misunderstood as an attempt to supersede other provisions of the section, including those sections that, as a matter of statutory law, could not be superseded by rule. Accordingly, VA is revising the paragraph to state that nothing in this section shall preclude the determination that a loan is being made

for a purpose authorized under 38 U.S.C. 3710, if the purpose of such loan is the refinancing of the balance due for the purchase of land on which new construction is to be financed through the proceeds of the loan, or the refinancing of the balance due on an existing land sale contract relating to a borrower's dwelling or farm residence. This is a technical change only, and VA intends no substantive impact.

F. Section 36.4306(g)

As with paragraph (f), paragraph (g) is overly broad. It could be interpreted as the sole provision within § 36.4306 related to manufactured homes. VA does not intend for paragraph (g) to be deemed a standalone provision, rendering the remainder of § 36.4306 inapplicable to manufactured homes. Instead, VA intends for paragraph (g) to be subject to the other relevant requirements (e.g., seasoning, recoupment, etc.) set forth in the section. Therefore, VA is inserting a new subparagraph (6), along with making the necessary grammatical edits to accommodate this addition, as a catch-all, to ensure that stakeholders understand “[a]ll other requirements of this section are met...” before VA will guarantee or insure the refinance of a manufactured home loan. VA intends this revision as a clarifying amendment only, without substantive impact.

G. Section 36.4306(h)

Section 3709 mentions VA’s statutory authority to insure refinancing loans. VA’s cash-out refinance rule has not specified how insurance works for cash-out

refinances. Although lenders almost always opt for guaranty, rather than insurance, the insurance of loans remains an option. Therefore, VA is adding § 36.4306(h) explaining that any refinancing loan that might be guaranteed under this section, when made or purchased by any financial institution subject to examination and supervision by any agency of the United States or of any State may, in lieu of such guaranty, be insured by the Secretary under an agreement whereby the Secretary will reimburse any such institution for losses incurred on such loan up to 15 percent of the aggregate of loans so made or purchased by it. This provision is a restatement of the law at 38 U.S.C. 3703(a)(2)(A).

III. Defining Home Equity

In § 36.4306, VA uses the term home equity and is therefore adding a definition of this term to § 36.4301. VA will define home equity as the difference between the home's reasonable value and the outstanding balance of all liens on the property. This definition is generally accepted in the financial industry and is modified to refer to VA's specific program terminology. See Home Equity, Investopedia, https://www.investopedia.com/terms/h/home_equity.asp (last visited Aug. 30, 2018).

Administrative Procedure Act

Section 309(a)(2) of the Act provides express authority for the Secretary to waive the requirements of 5 U.S.C. 551 through 559, e.g., advance notice and public comment requirements, if the Secretary determines that urgent or compelling circumstances make compliance with such requirements impracticable or contrary to the public interest. See Pub. L. 115-174, section

309(a)(2)(A). VA believes that, for the reasons explained below, delaying implementation of this rule until after VA could provide advance notice, solicit comment, and address public comments would be contrary to the public interest. In short, VA has determined that urgent and compelling circumstances exist to warrant the implementation of these regulatory amendments through an interim final rule.

It is important to note that the Act establishes a new standard, specific to the implementation of section 309 of the Act, for dispensing with advance notice and comment. The standard Congress created is separate and apart from the more generally applicable “good cause” exception under the Administrative Procedure Act, 5 U.S.C. 553(b)(B).

VA believes there are several urgent and compelling circumstances that make advance notice and comment on this rule contrary to the public interest. First, VA is concerned about a small group of lenders who continue to exploit legislative and regulatory gaps related to seasoning, recoupment, and net tangible benefit standards, despite anti-predatory lending actions that VA and Congress have already taken. VA’s regulatory impact analysis for this rule indicates that perhaps more than 50 percent of Type II Cash-Out refinances remain vulnerable to predatory terms and conditions until this rule goes into effect. VA believes that VA must immediately seal these gaps to fulfill its obligation to veterans, responsible lenders, and investors.

VA is also gravely concerned about constraints in the availability of program liquidity if VA does not act quickly to address early pre-payment speeds

for VA-guaranteed cash-out refinance loans. In large part, cash flows derived from investors in mortgage-backed securities (MBS) provide liquidity for lenders that originate VA-guaranteed refinance loans. When pricing MBS, investors rely on pre-payment models to estimate the level of pre-payments, and any resultant potential losses of revenue, expected to occur in a set period, given possible changes in interest rates. These pre-payment models tend to drive, at least in significant part, the valuation of such MBS. Buyers of VA-guaranteed loans, and other industry stakeholders have expressed serious concerns that early pre-payments of VA-guaranteed loans are devaluing these investments. See “Slowing Down VA Refi Churn Proving More Difficult Than Expected”, National Mortgage News (November 12, 2018), <https://www.nationalmortgagenews.com/news/slowing-down-va-refi-churn-proving-more-difficult-than-expected> (last visited Nov. 20, 2018). If such stakeholders view MBS investments that include VA-guaranteed refinance loans as less desirable, prudent lenders could be deprived of the cash flows, i.e. liquidity, necessary to make new VA-guaranteed loans to veterans.

Exacerbating the issue is the lending industry’s varied interpretation of the Act, which has led to lender uncertainty in how to implement a responsible cash-out refinance program. VA believes this uncertainty has caused responsible lenders to employ a high degree of caution, (e.g., refraining from providing veterans with crucial refinance loans that are not predatory or risky). Absent swift implementation of clear regulatory standards, cautious lenders are less likely to make cash-out refinance loans, which means that veterans do not enjoy

the widest range of competitive, responsible credit options that can, when used properly, result in placing the veteran in a better financial position than the veteran's current circumstances afford. Unfortunately, such caution has the potential to compound the risk of predatory lending, as irresponsible lenders have more opportunity to prey upon veterans.

At the same time, VA is concerned that certain lenders are exploiting cash-out refinancing as a loophole to the responsible refinancing Congress envisioned when enacting section 309 of the Act. VA recognizes there are certain advantages to a veteran who wants to obtain a cash-out refinance, and VA has no intention of unduly curtailing veterans' access to the equity they have earned in their homes. Nevertheless, some lenders are pressuring veterans to increase artificially their home loan amounts when refinancing, without regard to the long-term costs to the veteran and without adequately advising the veteran of the veteran's loss of home equity. In doing so, veterans are placed at a higher financial risk, and the lender avoids compliance with the more stringent requirements Congress mandated for less risky refinance loans. Essentially, the lender revives the period of subprime lending under a new name.

Lender uncertainty and the potential loophole may also cause investors to devalue VA refinance loans until VA steps in to resolve the issues. Thus, VA believes that, unless VA promulgates rules quickly, a loss of investor optimism in the VA product could further restrict veterans from being able to utilize their earned VA benefits.

VA does not plan to dispense with the notice and comment requirements altogether. Section 309(a)(2)(A)(ii) and (iii) of the Act requires VA, 10 days before publication of the rule, to submit a notice of the waiver to the House and Senate Committees on Veterans' Affairs and publish the notice in the Federal Register. Pub. L. 115-174, 132 Stat. 1296. VA has complied with these requirements. Section 309(a)(2)(B) further requires VA to seek public notice and comment on this regulation if the regulation will be in effect for a period exceeding one year. Pub. L. 115-174, 132 Stat. 1296. VA anticipates the regulation will be in effect past the one-year mark. Therefore, VA is seeking public comment on this rulemaking.

Executive Orders 12866, 13563, and 13771

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, when regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, and other advantages; distributive impacts; and equity). Executive Order 13563 (Improving Regulation and Regulatory Review) emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. Executive Order 12866 (Regulatory Planning and Review) defines a "significant regulatory action" requiring review by the Office of Management and Budget (OMB), unless OMB waives such review, as "any regulatory action that is likely to result in a rule that may: (1) Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector

of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order.”

The economic, interagency, budgetary, legal, and policy implications of this regulatory action have been examined, and it has been determined to be an economically significant regulatory action under Executive Order 12866. VA's impact analysis can be found as a supporting document at <http://www.regulations.gov>, usually within 48 hours after the rulemaking document is published. Additionally, a copy of the rulemaking and its impact analysis are available on VA's website at <http://www.va.gov/orpm/>, by following the link for “VA Regulations Published From FY 2004 Through Fiscal Year to Date.” This interim final rule is considered an E.O. 13771 regulatory action. Details on the estimated costs of this interim final rule can be found in the rule's economic analysis.

Congressional Review Act

This regulatory action is a major rule under the Congressional Review Act, 5 U.S.C. 801–08, because it may result in an annual effect on the economy of \$100 million or more. Therefore, in accordance with 5 U.S.C. 801(a)(1), VA will submit to the Comptroller General and to Congress a copy of this regulatory

action and VA's Regulatory Impact Analysis. Provided Congress does not adopt a joint resolution of disapproval, this rule will become effective the later of the date occurring 60 days after the date on which Congress receives the report, or the date the rule is published in the Federal Register. 5 U.S.C. 801(a)(3)(A).

Unfunded Mandates

The Unfunded Mandates Reform Act of 1995 requires, at 2 U.S.C. 1532, that agencies prepare an assessment of anticipated costs and benefits before issuing any rule that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more (adjusted annually for inflation) in any one year. This interim final rule will have no such effect on State, local, and tribal governments, or on the private sector.

Paperwork Reduction Act

This interim final rule includes provisions constituting collections of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3521) that require approval by OMB. Accordingly, under 44 U.S.C. 3507(d), VA has submitted a copy of this rulemaking action to OMB for review with a request for emergency processing.

OMB assigns control numbers to collections of information it approves. VA may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Section 36.4306 contains a collection of information under the Paperwork Reduction Act of 1995. If OMB does not approve the collection of

information as requested, VA will immediately remove the provisions containing a collection of information or take such other action as is directed by OMB.

Comments on the collections of information contained in this interim final rule should be submitted to the Office of Management and Budget, Attention: Desk Officer for the Department of Veterans Affairs, Office of Information and Regulatory Affairs, Washington, DC 20503 or emailed to OIRA_Submission@omb.eop.gov, with copies sent by mail or hand delivery to the Director, Regulation Policy and Management (00REG), Department of Veterans Affairs, 810 Vermont Avenue, NW, Room 1068, Washington, DC 20420; fax to (202) 273-9026; or submitted through www.Regulations.gov. Comments should indicate that they are submitted in response to “RIN 2900-AQ42 – Loan Guaranty: Revisions to VA-Guaranteed or Insured Cash-out Home Refinance Loans.”

OMB is required to make a decision concerning the collections of information contained in this interim final rule between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Notice of OMB approval for this information collection will be published in a future Federal Register document.

The Department considers comments by the public on proposed collections of information in--

- Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Department, including whether the information will have practical utility;
- Evaluating the accuracy of the Department's estimate of the burden of the proposed collections of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of the collections of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

The collection of information contained in 38 CFR 36.4306 is described immediately following this paragraph.

Title: VA-Guaranteed Home Loan Cash-out Refinance Loan Comparison Disclosure.

- Summary of collection of information: The new collection of information in 38 CFR 36.4306(a)(3) requires lenders to provide borrowers with a net tangible benefit test. To satisfy the net tangible benefit test, the new loan must meet certain loan criteria; the lender must provide a comparison of the terms of the borrower's current loan to the terms of the new loan; and the lender must provide the borrower a statement concerning the effects of refinancing on the borrower's home equity. This information must be

provided to the borrower by the lender in a standardized format not later than 3 business days of the refinance application and again at closing. The borrower must acknowledge receipt of this information on both occasions by signing the certification.

VA notes that it will not require lenders to complete a specific form. Instead, lenders will generate their own certification from their loan origination software. Additionally, any information and response to yes/no questions could be answered automatically by the information that the lender is inputting as they underwrite the loan. VA created a sample certification as an example, but this is not a required document or format. VA is only asking the lender to take the information they already collect from and provide to veterans, and display and provide that information into an easy to read format for the veteran.

- Description of need for information and proposed use of information: The information will be used by VA to ensure that the new loan meets the net tangible benefit test.
- Description of likely respondents: Lenders refinancing an existing loan product through a cash-out refinance loan.
- Estimated number of respondents: VA anticipates the annual estimated number of respondents to be 156,000 per year, which is based on a 3-year average of VA cash-out refinance loans. VA also estimates a one-time burden to the 16,000 loan officers who will require training on the new disclosure requirements.

The training estimate was derived from the 2017 Nationwide Mortgage Licensing System & Registry (NMLS) Industry Report showing 158,199 mortgage loan originators and the July 2018 Ellie Mae Origination Insight Report indicating that VA represents 10 percent of the national mortgage market. VA assumes that loan officers will learn about this new disclosure through annual NMLS TRID/TILA training.

- Estimated frequency of responses: Two times per loan for generating and disclosing the information to the borrower. One time for training purposes.
- Estimated average burden per response: 5 minutes (total for both instances of generation and disclosure). 5 minutes (for training).
- Estimated total annual reporting and recordkeeping burden: The total annual burden is 12,906 hours. This represents the ongoing annual burden of 12,480 hours to generate and provide the disclosure plus the one-time hour burden from training (1,280 hours) that has been annualized to 426 hours per year for the first three years. The total estimated annualized cost to respondents is \$483,458.76 (12,906 burden hours x \$37.46 per hour).
- VA also estimates a one-time technology cost associated with this information collection of \$1,266,366 (annualized to \$422,122 per year for the first three years). To derive this estimate, VA generated a high/low estimate of the one-time technology costs associated with this information collection. The low estimate assumes that 80 percent of

affected lending entities (i.e., 960 of the 1,200 active VA lenders who make cash-out refinance loans) will not be required to complete any technology upgrades as the software companies who supply their loan origination software (LOS) systems will update their products in time to enable these lenders to comply with the regulatory requirements. The costs therefore represent the costs to the remaining 20 percent of lenders (i.e., 240 lenders) that will need to complete a technology upgrade to generate the disclosure in their LOS. The high estimate assumes that no LOS product updates will be in place on time and all 1,200 lenders will be required to assume the costs of completing a technology upgrade to generate their disclosure.

VA calculated the one-time technology costs utilizing the amount of time estimated to develop a custom disclosure form (either through existing LOS software or via a third-party contract). VA assumed 40 hours of planning, development, testing, and deployment to add the disclosure form to a lender's existing LOS. The wage burden was calculated as a composite wage, with weighting based on information provided by various industry professionals. Mean values from the BLS Occupational Employment and Wages data were used to estimate a composite wage as 5% Compliance Officer (occupation code 13-1041) at \$34.39/hour, 5% Lawyer (occupation code 23-1011) at \$68.22/hour, and 90% Computer Occupations (occupation code 15-1100) at \$43.16/hour, for a composite wage of \$43.97.

VA estimated a high annualized cost of \$703,520 and a low annualized cost of \$140,704. VA therefore estimates that the average cost to be \$422,122.

Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), imposes certain requirements on Federal agency rules that are subject to the notice and comment requirements of the Administrative Procedure Act (APA), 5 U.S.C. 553(b). This interim final rule is exempt from the notice and comment requirements of the APA because the Act permitted VA to waive those requirements if the Secretary determined that urgent or compelling circumstances make compliance with such requirements impracticable or contrary to the public interest. As previously discussed, VA has found urgent and compelling circumstances to waive those requirements do exist. Therefore, the requirements of the RFA applicable to notice and comment rulemaking do not apply to this rule.

Nevertheless, VA does not anticipate that this interim final rule will have a significant impact on small business lenders. The Small Business Administration (SBA) states that a mortgage lending business (NAICS code 522292) is small if annual receipts are less than \$38,500,000. See 13 CFR 121.201. Utilizing FY2017 annual lender data and financial information, VA estimates approximately 22 percent (or 324) of its lenders qualify as a small business; of those who participate in VA cash-out loans, VA estimates 20 percent (or 238) of

its lenders qualify as a small business.¹ Of the 238 small business lenders who participate in VA cash-out loans, VA notes that 90 percent (216 lenders) completed no more than 20 VA cash-out loans in FY2017, suggesting that the impact of the statute and this regulation on their lending business will be minimal. In that regard, given that VA represents only 10 percent of the national mortgage market, it would be difficult for a small business to rely solely on VA loans in its portfolio. In fact, a sampling of VA small business lenders' websites shows that they all offer the full range of conventional, FHA, and VA loan products.

Relying on its industry knowledge, VA assumes that average loan volume for a one-person lending shop would be approximately 120 loans per year (or 10 loans per month). As such, even if such a lender were to no longer make any VA cash-out loans, it is likely this would represent no more than 20 percent of portfolio for the year. VA believes this is even too conservative of an estimate as its own lender statistics show that for most of its small business lenders (213 out of 238 lenders), VA cash-out loans represent less than half of their VA portfolio. For those whose VA portfolio is majority cash-out refinances, only six lenders completed more than 20 VA cash-outs in FY2017.

¹ Fiscal year (FY) 2017 data shows that 1,467 lenders participated in VA loans in FY2017. See VBA Lender Loan Volume Reports, "FY 2017," https://www.benefits.va.gov/HOMELOANS/Lender_Statistics.asp. VA first eliminated those whose total VA loan volume for FY2017 was greater than \$38.5 million (425 lenders). Of those remaining, VA removed any lenders who were part of a depository institution (i.e., a bank) as they would not fall within SBA's definition of a small business for NAICS code 522292, which specifically applies to non-depository credit. See 13 CFR 121.201. Of those remaining, VA consulted financial information provided by lenders to VA in 2017 for purposes of qualifying for automatic closing authority. If no annual financial data was available, VA assumed the lender was a small business. Of all VA lenders, data showed 324 lenders (22%) met the small business definition. For lenders who made VA cash-out loans in FY2017, 238 (19.8%) met the small business definition.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number and title for the program affected by this document is 64.114, Veterans Housing—Guaranteed and Insured Loans.

List of Subjects in 38 CFR Part 36

Condominiums, Housing, Individuals with disabilities, Loan programs-housing and community development, Loan programs-veterans, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Veterans.

Signing Authority

The Secretary of Veterans Affairs approved this document and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs. Robert L. Wilkie, Secretary, Department of Veterans Affairs, approved this document on September 12, 2018, for publication.

Dated: December 12, 2018

Jeffrey M. Martin,
Assistant Director,
Office of Regulation Policy & Management,
Office of the Secretary,

Department of Veterans Affairs.

For the reasons stated in the preamble, the Department of Veterans Affairs amends 38 CFR part 36 as set forth below:

PART 36 — LOAN GUARANTY

1. The authority citation for part 36 continues to read as follows:

Authority: 38 U.S.C. 501 and 3720.

Subpart B — Guaranty or Insurance of Loans to Veterans With Electronic Reporting

2. Amend § 36.4301 by adding a definition of home equity in alphabetical order to read as follows:

§ 36.4301 Definitions.

* * * * *

Home equity. Home equity is the difference between the home's reasonable value and the outstanding balance of all liens on the property.

* * * * *

3. Amend § 36.4306 by:

- a. Revising paragraphs (a) and (b).
- b. Redesignating paragraphs (c) and (d) as new paragraphs (d) and (e).
- c. Adding new paragraph (c).
- d. Revising newly redesignated paragraph (d) and paragraphs (f) and (g)(4) and (5).
- e. Adding paragraphs (g)(6) and (h).
- f. Revising the authority citation at the end of the section.

The revisions and addition read as follows:

§ 36.4306 Refinancing of mortgage or other lien indebtedness.

(a) A refinancing loan made pursuant to 38 U.S.C. 3710(a)(5) qualifies for guaranty in an amount as computed under 38 U.S.C. 3703, provided--

(1) The amount of the new loan must not exceed an amount equal to 100 percent of the reasonable value, as determined by the Secretary, of the dwelling or farm residence which will secure the loan.

(2) The funding fee as prescribed by 38 U.S.C. 3729 may be included in the new loan amount, except that any portion of the funding fee that would cause the new loan amount to exceed 100 percent of the reasonable value of the property must be paid in cash at the loan closing.

(3) The new loan must provide a net tangible benefit to the borrower. For the purposes of this section, net tangible benefit means that the new loan is in the financial interest of the borrower. The lender of the new loan must provide the borrower with a net tangible benefit test. The net tangible benefit test must be satisfied. The net tangible benefit test is defined as follows:

(i) The new loan must meet one or more of the following:

(A) The new loan eliminates monthly mortgage insurance, whether public or private, or monthly guaranty insurance;

(B) The term of the new loan is shorter than the term of the loan being refinanced;

(C) The interest rate on the new loan is lower than the interest rate on the loan being refinanced;

(D) The payment on the new loan is lower than the payment on the loan being refinanced;

(E) The new loan results in an increase in the borrower's monthly residual income as explained by § 36.4340(e);

(F) The new loan refinances an interim loan to construct, alter, or repair the primary home;

(G) The new loan amount is equal to or less than 90 percent of the reasonable value of the home; or

(H) The new loan refinances an adjustable rate mortgage to a fixed rate loan.

(ii) The lender must provide a borrower with a comparison of the following:

(A) The loan payoff amount of the new loan, with a comparison to the loan payoff amount of the loan being refinanced;

(B) The new type of loan, with a comparison to the type of the loan being refinanced;

(C) The interest rate of the new loan, with a comparison to the interest rate of the loan being refinanced;

(D) The term of the new loan, with a comparison to the term remaining on the loan being refinanced;

(E) The total the borrower will have paid after making all payments of principal, interest, and mortgage or guaranty insurance (if applicable), as scheduled, for both the loan being refinanced and the new loan; and

(F) The loan to value ratio of the loan being refinanced compared to the loan to value ratio under the new loan.

(iii) The lender must provide the borrower with an estimate of the dollar amount of home equity that, by refinancing into a new loan, is being removed

from the reasonable value of the home, and explain that removal of this home equity may affect the borrower's ability to sell the home at a later date.

(iv) The lender must provide the information required under paragraphs (a)(3)(i) through (iii) of this section in a standardized format and on two separate occasions: not later than 3 business days from the date of the loan application and again at loan closing. The borrower must certify that the borrower received the information required under paragraphs (a)(3)(i) through (iii) on both occasions.

(4) The dollar amount of discount, if any, to be paid by the borrower must be reasonable in amount as determined by the Secretary in accordance with § 36.4313(d)(7)(i).

(5) The loan must otherwise be eligible for guaranty.

(b) If the loan being refinanced is a VA-guaranteed or insured loan, and the new loan amount is equal to or less than the payoff amount of the loan being refinanced, the following requirements must also be met--

(1)(i) The lender of the refinanced loan must provide the Secretary with a certification of the recoupment period for fees, closing costs, and any expenses (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) that would be incurred by the borrower in the refinancing of the loan;

(ii) All of the fees and incurred costs must be scheduled to be recouped on or before the date that is 36 months after the date of loan issuance; and

(iii) The recoupment must be calculated through lower regular monthly payments (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) as a result of the refinanced loan.

(2) The new loan may not be guaranteed or insured until the date that is the later of 210 days from the date of the first monthly payment made by the borrower and the date on which the sixth monthly payment is made on the loan.

(3) In a case in which the loan being refinanced has a fixed interest rate and the new loan will also have a fixed interest rate, the interest rate on the new loan must not be less than 50 basis points less than the loan being refinanced.

(4) In a case in which the loan being refinanced has a fixed interest rate and the new loan will have an adjustable rate, the interest rate on the new loan must not be less than 200 basis points less than the previous loan. In addition--

(i) The lower interest rate must not be produced solely from discount points, unless such points are paid at closing; and

(ii) Such points are not added to the principal loan amount, unless—

(A) For discount point amounts that are less than or equal to one discount point, the resulting loan balance after any fees and expenses allows the property with respect to which the loan was issued to maintain a loan to value ratio of 100 percent or less; and

(B) For discount point amounts that are greater than one discount point, the resulting loan balance after any fees and expenses allows the property with respect to which the loan was issued to maintain a loan to value ratio of 90 percent or less.

(c) If the new loan amount exceeds the payoff amount of the loan being refinanced—

(1) The borrower is deemed to have recouped the costs of the refinancing if the requirements prescribed in paragraph (a) are met.

(2) The new loan may not be guaranteed or insured until the date that is the later of 210 days from the date of the first monthly payment made by the borrower and the date on which the sixth monthly payment is made on the loan; however, this requirement applies only when the loan being refinanced is a VA-guaranteed or insured loan.

(d) For the limited purpose of calculating entitlement, nothing shall preclude guaranty of a loan to an eligible veteran having home loan guaranty entitlement to refinance under the provisions of 38 U.S.C. 3710(a)(5) a VA-guaranteed or insured (or direct) mortgage loan made to him or her which is outstanding on the dwelling or farm residence owned and occupied or to be reoccupied after the completion of major alterations, repairs, or improvements to the property, by the veteran as a home, or in the case of an eligible veteran unable to occupy the property because of active duty status in the Armed Forces, occupied or to be reoccupied by the veteran's spouse as the spouse's home.

* * * * *

(f) Nothing in this section shall preclude the determination that a loan is being made for a purpose authorized under 38 U.S.C. 3710, if the purpose of such loan is the refinancing of the balance due for the purchase of land on which new construction is to be financed through the proceeds of the loan, or the

refinancing of the balance due on an existing land sale contract relating to a borrower's dwelling or farm residence.

(g) * * *

(4) The amount of the loan may not exceed an amount equal to the sum of the balance of the loan being refinanced; the purchase price, not to exceed the reasonable value of the lot; the costs of the necessary site preparation of the lot as determined by the Secretary; a reasonable discount as authorized in § 36.4313(d)(6) with respect to that portion of the loan used to refinance the existing purchase money lien on the manufactured home, and closing costs as authorized in § 36.4313.

(5) If the loan being refinanced was guaranteed by VA, the portion of the loan made for the purpose of refinancing an existing purchase money manufactured home loan may be, guaranteed without regard to the outstanding guaranty entitlement available for use by the veteran, and the veteran's guaranty entitlement shall not be charged as a result of any guaranty provided for the refinancing portion of the loan. For the purposes enumerated in 38 U.S.C. 3702(b), the refinancing portion of the loan shall be considered to have been obtained with the guaranty entitlement used to obtain VA-guaranteed loan being refinanced. The total guaranty for the new loan shall be the sum of the guaranty entitlement used to obtain VA-guaranteed loan being refinanced and any additional guaranty entitlement available to the veteran. However, the total guaranty may not exceed the guaranty amount as calculated under § 36.4302(a); and

(6) All other requirements of this section are met.

(h) Any refinancing loan that might be guaranteed under this section, when made or purchased by any financial institution subject to examination and supervision by any agency of the United States or of any State may, in lieu of such guaranty, be insured by the Secretary under an agreement whereby the Secretary will reimburse any such institution for losses incurred on such loan up to 15 percent of the aggregate of loans so made or purchased by it.

(Authority: 38 U.S.C. 3703, 3709, 3710)

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